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FM AMEMBASSY HARARE
TO RUEHC/SECSTATE WASHDC PRIORITY 2045
INFO RUCNSAD/SOUTHERN AFRICAN DEVELOPMENT COMMUNITY
RUEHUJA/AMEMBASSY ABUJA 1738
RUEHAR/AMEMBASSY ACCRA 1613
RUEHDS/AMEMBASSY ADDIS ABABA 1742
RUEHBY/AMEMBASSY CANBERRA 1022
RUEHDK/AMEMBASSY DAKAR 1371
RUEHKM/AMEMBASSY KAMPALA 1799
RUEHNR/AMEMBASSY NAIROBI 4228
RUEHGV/USMISSION GENEVA 0863
RHEHAAA/NSC WASHDC
RHMFISS/JOINT STAFF WASHDC
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEFDIA/DIA WASHDC//DHO-7//
RUCPDOC/DEPT OF COMMERCE WASHDC
RUFOADA/JAC MOLESWORTH RAF MOLESWORTH UK//DOOC/ECMO/CC/DAO/DOB/DOI//
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C O N F I D E N T I A L SECTION 01 OF 05 HARARE 000951

SIPDIS

SIPDIS

AF/S FOR S. HILL
NSC FOR SENIOR AFRICA DIRECTOR B. PITTMAN
STATE PASS TO USAID FOR L.DOBBINS AND E.LOKEN
TREASURY FOR J. RALYEA AND T.RAND
COMMERCE FOR BECKY ERKUL
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS

E.O. 12958: DECL: 01/12/2016
TAGS: ECON EFIN PGOV ZI
SUBJECT: WILDLY INFLATIONARY NEW MONETARY POLICY

REF: A. HARARE 822
¶B. HARARE 657
¶C. HARARE 605

Classified By: Pol/Econ Deputy Chief Frances Chisholm under Section 1.4 b/d

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Summary

¶1. (SBU) Reserve Bank of Zimbabwe (RBZ) Governor Gono issued a wildly inflationary Mid-Term Monetary Policy Statement (MPS) on October 1. With concessional loans at 25 percent interest across industry and agriculture and the promise of hard currency payments to productive grain farmers, Gono is betting on engineering a quick supply-side rebound to the economy. The Governor also announced an overnight facility that effectively devalued the local currency for exporters, tighter control over NGO foreign currency accounts (FCA), and the imminent introduction of another set of bearer cheques to solve the recurring accounting and transaction problems of hyperinflation. Gono presented gloomy economic indicators including 17,000 percent money supply growth, a decline in the value of exports, and mounting external debt. He reverted to blaming Zimbabwe's woes on "declared and undeclared sanctions." He did, however, call for moderation in implementing indigenization of industry, particularly the banking sector.

¶2. (C) Economic analysts pointed out the inflationary impact of the expansionary monetary policy at a time of 5-digit inflation and empty hard-currency coffers. The local currency has swooned on the parallel market this month in a vote of no-confidence in monetary and fiscal policies and in

reaction to an RBZ forex buying spree on the street. The weak economic indicators are unlikely to improve any time soon in the face of loose fiscal policy and disregard for comprehensive economic reform. End Summary.

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On RBZ Off-Budget Spending: "We Are Not Buffoons"
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¶3. (U) Defending expansionary monetary policies as he introduced the Mid-Year Monetary Policy Statement on October 1, 2007, Gono said "we are not buffoons who do not appreciate the immediate inflationary impact of our quasi-fiscal interventions." He reassured Zimbabweans that the inflationary effects of the policies would be short-term and more than off-set by medium to long-term benefits. Stating that, for now, "the game is one of survival," he announced:

-- a 25 percent interest facility for the productive sectors of the economy, dubbed Basic Commodities Supply Intervention (BACOSI);

-- a reduction in the rate of interest of the Agricultural Sector Productivity Enhancement Facility (ASPEF) to 25 percent from 50 percent;

-- import-parity price payment to farmers growing "strategic crops" of maize, wheat, soy beans, sugar beans, barley and sunflower; and a maize delivery bonus of Z$5.8 million per tonne, backdated to April, 2007;

-- an increase in the gold support price to Z$5 million per

gram (Note: The support price was Z$350,000 at the start of the year. End Note).

Devaluation By Any Other Name

¶4. (U) Gono announced a facility for exporters to redeem their foreign currency earnings at Z$30,000:US$1 (i.e. the official exchange rate) and invest the funds overnight at 800 percent interest, thus realizing an effective exchange rate of Z$270,000:US$1. He also announced:

-- a centralized system for the twice-weekly allocation of foreign currency to be based on a national priority list that ranks fuel, food and agricultural inputs high;

-- a modest increase in the amount of foreign currency earnings that an exporter may retain from 60 percent to 65 percent, but a reduction in the retention period to 30 days;

-- an increase in the foreign currency retention threshold for tobacco growers from 20 percent to 25 percent starting in 2008, and a commitment by the RBZ to settle all outstanding foreign currency account entitlements (about US$20 million) for the 2007 tobacco selling season by October 31, 2007;

-- an increase in overnight accommodation rates to 800 percent and 850 percent for secured and unsecured lending respectively;

-- exporters may now apply to the RBZ for approval to offer "innovative foreign exchange based packages" to specialized labor;

-- a nation-wide initiative to provide electric generators ("details to be announced") in a "noble supplementary electricity supply programme."

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Tighter Control On NGO Funds and Currency Exchange
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¶5. (U) In the MPS, the RBZ instituted a new requirement that corporate foreign currency accounts (FCA) be lodged at the RBZ, including NGO accounts (but not embassy accounts). NGOs must now apply to the RBZ through their financial institutions to withdraw or transfer foreign exchange. Funds exchanged for local currency will have to be converted at the official exchange rate or at Z$270,000:US$1 with the newly created overnight instrument.

¶6. (SBU) The new requirement risks RBZ interference in payments or, at worst, confiscation of funds. So far, NGOs have reported only minor delays in routine withdrawals for payroll disbursements and program costs, but as the value of the local currency swooned this week, the amount of money that NGOs get for local currency expenses is eroding quickly. The NGOs are exerting pressure on the RBZ to reverse the policy, and there are some indications that the RBZ might back down and reverse the policy.

Hold Onto Your Seat, Three More Zeros Soon To Go

¶7. (U) With hyperinflation having eroded the accounting and

transaction benefits of lopping three zeros off the currency 14 months ago, Gono announced the imminent begin of "Sunrise II") the introduction of yet another set of bearer notes. He said there would be very little time allowed for the exchange of notes in the changeover, and the permitted amount of cash deposits would be kept low.

An Overview of Dismal Economic Performance

¶8. (SBU) Gono also presented economic indicators of the past months: Broad money supply growth was 17,073 percent year-on-year in July 2007, up from 1,638 percent in January; gold deliveries fell 24 percent during January to August 2007 to 5 metric tonnes from 6.6 metric tones during the same period in 2006. A supplement to the Statement showed the US dollar value of commodity exports since 2000, and also Zimbabwe's external debt by creditor, including all arrears. Highlights in the projection for 2007 are:

-- a 7.6 percent decline in the value of commodity exports;

-- a decline of 21 percent in the value of gold exports and 13 percent in platinum; an increase of 9 percent in nickel;

-- a decline of 8 percent for sugar, 5 percent for horticulture; an increase of 5 percent for tobacco;

-- an 11 percent decline in manufacturing overall, with a 33 percent decline in iron and steel, 6 percent decline in ferro alloys and 3 percent decline in cotton lint;

-- US$4.409 billion total external debt at end August 2007 (up from US$4.246 in 2006);

-- total public and publicly guaranteed debt as a percentage of GDP of 103 percent at end August 2007;

-- GDP of US$ 4.037 billion at end August 2007

Vitriol Against "Prophets of Regime Change" and "Sanctions"

¶9. (U) Gono defended the government's disastrous price crackdown (Refs A, B, C) begun in late June. He attacked the "selfish, arbitrary, and in some cases well co-ordinated pricing madness" of the business community, as well as the

"prophets of regime change," and other "dooms-day mongers, who had been predicting the imminent collapse of the economy."

¶10. (SBU) Jabbing further, and in reference to the GOZ's payment of arrears to EXIM in June 2007, Gono lambasted "one very powerful Western Nation creditor" for having threatened "unspecified punitive action" unless Zimbabwe paid arrears of US$45 million. In addition, nearly two years after the fact, Gono was also still licking his wounds over the "injustice" of Zimbabwe failing to regain IMF voting rights and access to technical assistance and loans despite clearing its arrears to the IMF General Resources Account.

¶11. (U) He blamed Zimbabwe's woes on "declared and undeclared sanctions" and denounced westerners for causing tribulations from failure to get a decent burial to hospital doctors operating in darkness. The RBZ issued a glossy 21-page

supplement to the Statement on "The Impact of Sanctions Against Zimbabwe," which also appeared as a supplement in the government-run daily newspaper The Herald under the headline "Sanctions Hit Poor Hardest"

But Moderation on Indigenization

¶12. (U) On the other hand, Gono argued for a balanceto be struck between the objectives of indigenization and the need to attract foreign investment. He called for caution and flexibility in implementing the policy and advised against rushing to achieve the 51 percent target of the Indigenization and Economic Empowerment Bill, which is now pending President Mugabe's assent. Gono referred in his Statement to "reported incidences involving a number of senior and well-connected personalities who are already positioning themselves to muscle into certain mining, manufacturing, financial and other entities that are currently performing well and contributing to the foreign currency inflows of the country."

¶13. (SBU) Asked by Swiss Ambassador Marcel Stutz at Gono's briefing to the diplomatic community on October 2 how he expected to attract foreign investment, the Governor was at pains to convince the diplomats that government would not implement indigenization overnight. He singled out banking as an area where the RBZ would conduct due diligence to avoid asset stripping by purported investors, as he admitted had happened in agriculture. In the meantime, Fred Mutanda, Chairman of the Association of Money Transfer Agents, told us on October 17 that Gono had informed representatives of the financial services sector that they could rest assured that President Mugabe would not sign the Indigenization Bill.

¶14. (U) The Governor concluded the Statement with the optimistic promise that most basic goods "should and will" return to the shelves within the next three to four weeks.

The Economists' View

¶15. (SBU) The consensus among economic analysts outside government circles is that the new policies are expansionary and likely to further fuel inflation. Although on the face of it concessionary lending to industry and agriculture at 25 percent interest could engineer a quick supply response in conjunction with a comprehensive economic reform package, there is neither an indication of how the RBZ will finance the facilities, nor a policy framework of economic reform. (Note: The official rate of inflation in September was 7,892 percent, but a leading supermarket chain calculated the rate at around 28,000 percent. End Note)

¶16. (C) While raising the foreign currency retention threshold from 60 to 65 percent injects a bit more liquidity into the foreign exchange market, its positive effect on exporters is likely to be offset by the shorter foreign exchange retention period. Indeed, the RBZ's latest sleight of hand that increases an exporter's foreign exchange rate nine-fold overnight would augment foreign exchange reserves under normal conditions. However, since the announcement, the local currency has swooned from Z$500,000 to Z$900,000:US$ on the informal market, taking the shine off the deal. The RBZ is the main driver of the plummeting

exchange rate as it buys up foreign exchange on the street. Dealers are selling stacks of RBZ-packaged, freshly printed notes to forex holders all over town and one senior RBZ official told us that the bank is offering exporters Z$1,000,000:US$ for amounts of US$10,000 and above.

¶17. (SBU) While farmers welcomed the adoption of import parity pricing of some crops, they complained that the prices, especially for maize, were pegged too low, and doubted whether the RBZ would or could honor its foreign currency payment commitments in light of the RBZ's poor track record of hard currency payments to tobacco farmers (and to gold producers, as well, for that matter).

Comment

¶18. (SBU) In a quickening spiral of economic decline, and with elections on the horizon, the RBZ has adopted a something-for-everyone approach to monetary policy. As the 2008 elections draw closer, we anticipate even more expansionary fiscal policies. In line with recent trends, the RBZ is likely to resort to raising reserve requirements and to the printing press to fund the commitments, which will lead to rapid money supply growth and, invariably, more inflation. Indeed, in light of the expansionary fiscal policy adopted in the supplementary budget in September 2007, it will be next to impossible for the RBZ to curtail monetary expansion in the next months.

¶19. (SBU) The Governor's comments on indigenization are both refreshing and daring, coming so soon after passage of the Indigenization and Economic Empowerment Bill. While we hope that Gono has it right that Mugabe will indeed sit on the Bill rather than sign it, the additional uncertainty in itself, typical as it is, further unnerves potential investors in this rapidly deteriorating economic environment.

DHANANI